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ACTIONS OF THE DEPARTMENT OF DEFENSE TO IMPROVE THE INTERNATIONAL BALANCE OF PAYMENTS DEFICIT

by
Matthew E. Anglim, Jr.
Lieutenant Commander
Supply Corps, U. S. Navy

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Bachelor of Science
United States Naval Academy, 1954

A Thesis Submitted to the School of Government and
Business Administration of The George Washington
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CHAPTER I

INTRODUCTION

General

In the early 1960's the role of the United States as a leader of the free world as well as the economy of this country, was more seriously affected by international economic forces than at any time in recent peacetime history. The strength of the United States, both at home and abroad, was linked with the strength of the dollar and the dollar, was and still is the primary currency in the Free World's financial structure. While the dollar still commanded a high degree of confidence throughout the world, it had lost some of its luster and its strength relative to other currencies. The dollar was no longer free from occasional fears and suspicions. This condition had been brought about by the persistent and sizable deficits in the United States International Balance of Payments.

There was unanimous agreement on the need for the United States to bring its international accounts into equilibrium. The importance of a strong dollar was most clear, not solely because of the role it played in providing the world's monetary base, but primarily to provide the strength to the voice of the United States in political, military and economic dealings with other nations.

The United States rejected the classical measures of devaluation and import restrictions (measures generally taken by other countries when plagued with continuing payments deficits and reserve losses) as a means for solving its balance of payments problem. Instead, the United States chose to redress the deficit in a gradual and discretionary fashion in all categories of transactions which make up the balance of payments. Concentrated action was taken in an effort to increase United States exports in the flow of trade between the United States and other nations. Legislation was initiated which was designed with the goal of slowing down private capital outflow from the United States for long term foreign investment. The Federal Reserve Board took action which was designed to increase domestic short-term interest rates and thereby retard the outflow of short-term capital from the United States. The Department of Defense implemented various actions to reduce the foreign exchange costs associated with our overseas military commitments.

The determination of the United States to balance its international transactions within the overall National Security Objectives is reflected in the following excerpt from President John F. Kennedy's address to the International Monetary Fund, Washington, D. C. on September 30, 1963:

> We are determined to do whatever must be done in the interest of this country and, indeed, in the interest of all to protect the dollar as a convertible currency at its current fixed rate.
>
> We are determined and I believe in your interests as well as our own to maintain the firm relationship of gold and the dollar at the present price of thirty five dollars an ounce, and I can assure you will do just that.

> We do not seek by precipitous acts to improve our position at the expense of others. We do seek by comprehensive effort, consistent with our international responsibilities to reduce outflows which are weakening our capacity to serve the world community. In short, every nation in the world has a direct interest, for the dollar is an international currency, and the security of the dollar therefore involves the security of us all.

During the five year period 1958 through 1962, the net deficits in the United States balance of payments averaged a little more than three billion dollars per year. During this same period, the deficits associated with our overseas military commitments slightly exceeded the average annual net deficits. Since these military deficits represented the largest single adverse factor in the United States balance of payments position and fell within the public sector - thus controllable by the Federal Government, they were considered by many as the prime cause of the overall balance of payments deficits and were the initial target for action in solving the problem. The Department of Defense initiated vigorous economy efforts to hold down and reduce overseas expenditures; however, since our forces overseas represented an integral part of the nation's defense programs, it was intended that these reductions be accomplished without jeopardizing essential national security objectives.

Purpose

The chief purpose of this dissertation is to review the actions taken by the Department of Defense to reduce overseas expenditures in order to curb the out flow of "gold," which became a significant concern of

President Kennedy immediately following his inauguration. The examination, therefore, will focus on the time frame of 1958 to the official beginning of the Vietnamese Intervention (which is the Tonkin Incident of August 1964). Additionally, this paper will consider other proposed actions for the reduction of overseas expenditures which could be taken without jeopardizing the security objectives of the defense programs of the United States and its Allies.

Methodology

The approach used in the development of this effort is that of library research. The bulk of the source material used herein came from public documents, Department of Defense files, and interviews with responsible government and civilian officials knowledgeable in the area under examination. It should be noted, however, that numerous secondary works were reviewed and utilized also.

Chapter II will attempt to summarize the material presented and to offer various conclusions derived therefrom.

Chapters III and IV will attempt to describe and analyze the actions of the Department of Defense in trying to accomplish a reduction in the Balance of Payments Deficit.

Chapter V will attempt to provide a brief overview of reporting problems in the Balance of Payments Deficit.

CHAPTER II

BALANCE OF PAYMENTS DEFICITS AND RELATED PROBLEMS

Spending, borrowing and lending, and investing are not confined within national boundary lines. Consumers and business firms in the United States buy goods and services from all over the world. United States citizens and business firms lend and invest in foreign countries; foreigners lend and invest in the United States. United States financial institutions and business concerns pay interest and dividends on foreign investments in this country and, in turn, receive income on funds invested abroad. United States citizens have always spent large amounts for foreign travel; foreign visitors always spend in the United States. The United States Government makes payments abroad; foreign governments make payments here. These are only a few illustrations on the multitude of transactions that crisscross national boundaries. Some transactions result in receipts from others in payments to foreign countries.[1] A summary tabulation of all of these transactions during a given period of time is commonly referred to as the "Balance-of-Payments." If

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[1] Clay J. Anderson, "Defending the Dollar" in Federal Reserve Bank of Philadelphia Publication, November 1962, p. 1.

payments are larger than receipts, a country has a deficit; if receipts are larger than payments, it has a surplus in its international balance of payments.

Except for the year 1957, the United States balance of payments has shown a deficit every year since 1950. Between 1950 and 1956, the deficits averaged one and one-half billion dollars per year and were of no real concern to the United States:

> These earlier deficits in our balance-of-payments were, in fact, favorable in their world effect. They helped to restore foreign monetary systems by enabling foreign governments to earn the dollars which they needed to rebuild their international reserve. They made it possible for the industrialized countries of Western Europe to restore the convertibility of their currencies, thus freeing world trade and payments from exchange control. This was a benefit to the export trade of the United States.[2]

Furthermore, the payments deficits generated during this period caused little loss of gold from the United States gold reserves. Because of the special role of the dollar as a standard and store of value, it became convenient for foreign commercial banks to hold large operating balances of United States dollars as the medium of international exchange. In addition, it became a matter of policy for many foreign financial institutions to hold part of their official reserves in dollars or dollar claims (deposits with United States banks and United States Treasury obligations).

In 1957, the United States balance of payments

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[2] John F. Kennedy, Message to Congress on Balance of Payments and Gold, February 6, 1961, Congressional Quarterly Almanac, Vol. XVII, 1961.

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In 1957, the United States balance of payments reflected a small surplus. This was the result of the abnormal increase in United States exports of petroleum and petroleum products during the Suez crisis.

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[2] John F. Kennedy, *Message to Congress on Balance of Payments and Gold*, February 6, 1961; Congressional Quarterly Almanac, Vol. XVII, 1961.

Beginning with 1958, and continuing for a five year period, the United States balance-of-payments reflected large deficits which averaged a little over three billion dollars per year. Unlike the conditions that existed during 1950-56 period when commercial banks and foreign institutions were building their dollar operating accounts and reserves, the large payments deficits generated during the 1958 thru 1962 period were accompanied with a loss of gold from the United States gold reserves. Foreign financial institutions were converting the growing supply of dollars into gold by buying gold from the United States Treasury. Out of the nearly sixteen billion dollar cumulative 1958-1962 deficits, almost seven billion dollars of gold reserves were transferred to foreign ownership. This represented a thirty per cent decline in United States gold stocks from that held in 1957.

> The gold transfers did not make the underlying balance of payments fundamentally worse. They did reflect a decision by foreigners to take more of their earnings in gold and to hold less in dollars.[3]

The loss of seven billion dollars of gold reserves was not, in itself, the basis of concern since the United States still had approximately seventeen billion dollars of gold reserves, which represented forty per cent of the free world's gold holdings. The official concern, in the United States and abroad, was that foreign countries held

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[3] _Ibid_.

about twelve billion dollars worth of their official reserves in the form of dollar claims which were redeemable in gold from the United States Treasury. Furthermore, short-term and other liquid liabilities of the United States, in the form of dollar claims held by foreigners, had grown to approximately fifteen and one-half billion dollars. These dollar claims could readily find their way into foreign financial institutional channels and then be used to buy additional gold from the United States Treasury. The combined total of official and unofficial "gold" claims exceeded the amount of the United States gold reserves.

The receipts and expenditures which made up the United States balance of payments resulted from a great number of transactions. It was the combined effect of all of these transactions that generated the payments deficits. While the causes of the deficits cannot always be clearly pinpointed, grouping the transactions into major components or categories can identify the strengths and weaknesses of the United States balance of payments.

Exports and Imports of Goods and Services

The United States had had a surplus on goods and services for many years. Receipts from sales of merchandise, services rendered foreigners, and income on foreign investments had substantially exceeded payments to foreigners for these purposes. The annual surplus on goods and services from 1949 to 1960 had ranged from a low of about two billion dollars to a high of over eight billion dollars. In 1961, the surplus exceeded seven billion

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addition to the recorded transactions, there is reasonable evidence that a large percentage of the deficits in the "Unrecorded Transactions" represents outflow of short-term private capital.[7]

On the basis of this it could be concluded that the balance-of-payments difficulties of the United States were the direct result of United States private capital movements abroad. Such a conclusion, based upon the statistics alone, would be superficial. It has been established that the outflow of private capital in some instances replaced the need for United States Government loans and grants, thereby helping to moderate the deficits in the "United States Government Account" sector of the balance of payments. Others have identified private capital outflow with the export of capital equipment, raw materials and goods which in turn, contributes to the surplus in the "Export of Goods and Services" sector of the balance of payments. These factors, coupled with the sizable earnings that are made from the foreign investments, gives rise to serious questions on whether United States private long-term capital movements abroad were detrimental or beneficial to the United States balance of payments.

The views expressed by some that investments abroad benefit the United States balance-of-payments is substantiated in a study, prepared by Standard Oil Company of New Jersey, of the accounts of approximately two hundred addition to the recorded transactions, there is reasonable evidence that a large percentage of the deficits in the "unrecorded transactions" represents outflow of short-term private capital.[7]

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[7] Philip W. Bell, "Private Capital Movements and the United States Balance of Payment Position," 78th Congress, 3d Session, Joint Committee Publication, Factors Affecting the United States Balance of Payments, U. S. Government Printing Office, Washington, D. C., 1962, pp. 395 thru 484.

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United States oil companies who operated internationally for five years or longer. This study shows that profits from oil operations abroad, together with proceeds of United States oil equipment sold overseas, more than outweighed the total capital outflow for oil investment abroad and expenditures on oil imported into the United States. The net outflow resulting from international oil trading by United States companies amounted to $638 million in 1962 and to $1,635 million from 1958 to 1963.[8]

Walter S. Salant, in his book "U. S. Balance of Payments in 1968" indicates that:

> The weakening in the balance of payments caused by a new flow of funds from the United States is matched by the cumulation of annual inflows of funds resulting from the original investment somewhere between the fifth and sixth year following the investment. By the end of the tenth year, the sum of the inflows is more than double the original outflow and the beneficial effects continue at a growing rate thereafter.[9]

If, in fact, United States private investments abroad were beneficial to the long-term United States balance-of-payments and they were greatly instrumental in maintaining the international solvency of the United States--assets of seventy-seven billion dollars (total United States investments abroad) far exceeded liabilities of fifty billion dollars (total foreign investments in the United States) the question arises: what was the concern about the balance-of-payments deficits and specifically why were actions considered to stem the flow of

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[8] "USA, Oil Helps Payments Balance," Published in Petroleum Press Service, Volume XXX, No. 2, December 1963.

[9] Walter S. Salant (and others), "U. S. Balance of Payments in 1968," Brookings Institute, p. 145, pp. 298.

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If, in fact, United States private investments abroad were beneficial to the long-term United States balance-of-payments and they were probably instrumental in maintaining the international solvency of the United States—assets of eighty-seven billion dollars (total United States investments abroad) are exceeded liabilities of fifty billion dollars (total foreign investments in the United States)—the question arises: what was the concern about the balance-of-payments deficits and specifically why were actions considered to stem the flow of

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[8] Ibid., "Oil Helps Payments Balance," Published in Petroleum Press Service, Volume XXXI, No. 2, December 1964.

[9] Walter S. Salant (and others), "U. S. Balance of Payments in 1968," Brookings Institute, p. 145, no. 286.

United States private investment to foreign countries?

The answers to these questions deals with the immediate effects the long-term investments had on the United States balance-of-payments and their direct bearing on the liquidity position of the United States. More than one-half of the fifty billion dollars liabilities to foreigners were short-term. They consisted mainly of time deposits at commercial banks, United States government securities, commercial paper and demand deposits in American banks. Foreign governments and international organizations accounted for the largest part of dollar claims against the United States. The willingness of foreigners to hold dollars and dollar claims is based on the belief that they will be able to convert their dollars into gold and that the prevailing price or conversion rate of thirty-five dollars per ounce of gold will not be altered. Only official holders--governments and central banks--can convert their dollar holdings into gold. Foreign private holders of dollars and dollar claims, on the other hand, cannot buy gold from the United States. However, when their short-term dollars and dollar claims greatly exceed the amount they need as working balances in conducting international transactions, they will normally convert dollars into their local or other needed currencies. In this way, foreign dollar holdings could shift from private to offical hands, and from a potential claim to a possible direct claim against our gold reserves. The potential and possible dollar claims exceeded our total gold reserves during this period. Any loss of confidence that the United States would maintain the value of the dollar

could generate a sudden massive international transfer of private dollar claim holdings and subsequently a "run" on the United States gold reserves.

In contrast to the foreign investments in the United States, over sixty-five per cent of the seventy-seven billion dollars worth of United States investments abroad were private long-term investments and could not be quickly disposed of for foreign currencies without great loss. The United States long-term foreign investments were of little value to counter a "run" upon the United States gold reserves.

In July 1963, several moves were directed by the Kennedy Administration at different elements in the private capital situation. First, the Federal Reserve Board allowed interest rates to rise with the aim of reversing or at least reducing the outflow of short-term funds. Secondly, an "Interest Equalization Tax" was proposed to raise the cost of foreign borrowing in the United States capital market. Thirdly, substantial cuts in taxation were proposed to stimulate more investment at home. Finally, a number of financial devices, including currency "swaps" with central banks of other countries, were adopted with the objective of reducing foreign holdings of dollars convertible into gold. The results of these moves led to a marked improvement in the United States balance-of-payments during the third quarter of 1963.[10]

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[10] "Oil and the U. S. Payments Crisis," Petroleum Press Service, Volume XXX, No. 11, November 1963.

United States Government Transactions

United States Government payments abroad were much larger than receipts from foreign governments. In 1961, payments exceeded receipts by nearly six billion dollars and the net outflow on United States government transactions averaged about this amount annually during the period 1958-1963. The two major categories of transactions contributing to the deficits in this area were: (1) Defense Expenditures abroad for goods and services; and, (2) Transactions associated with the United States Foreign Assistance Programs.

Defense transactions will be discussed in detail in the next chapter.

United States Foreign Assistance Programs

From 1946-1964, extensive aid by the United States assisted foreign countries to have fewer import restrictions, to control currency devaluations, and to accumulate dollar reserves that staved off economic and political chaos and collapse. Programs of reconstruction and development were carried on, levels of production were raised, dependence on the United States gradually reduced, native political stability was enhanced, and military rearmament speeded up in order to resist totalitarian encroachments.

The foreign aid programs that evolved in form and scope helped to serve the national objectives of this country and to deal effectively with the changing international situation. The programs of 1947 to Greece and Turkey were primarily military and enabled these countries to withstand external communist pressures and to put down

internal communist inspired aggression. The aid to Western Europe, commencing in 1947, was essentially economic in nature with its stated purpose of promoting industrial and agriculture production, securing financial stability, and aiding international trade relations. Again, for a time during the period of the Korean conflict, the principal goal of foreign assistance was to develop military strength and to shore up unstable economies on the periphery of the communist world. As of 1964, two-thirds of all assistance was devoted to the objective of promoting economic and social progress in under developed countries. Another important trend in foreign assistance was the shift from grants to loans. Under the Marshall Plan, almost ninety per cent of aid to Europe was in the form of grants. The technical assistance and supporting assistance that followed also employed grants as the major instrument of aid. However, as the concept of long-term development and concentration of resources grew, loans became the principal form of assistance. For example the fiscal year 1964 budget for the Agency for International Development called for sixty per cent of its program to be in the form of loans.

It was claimed that United States foreign assistance was responsible for the balance-of-payments deficit and the gold drain and that the elimination of the program would not only solve the problem but would reduce government expenditures and tax needs, at least in that area. Proponents of foreign aid contended that peaceful assistance is constructive and cheaper than armaments powerful enough to yield equivalent protection.

President John F. Kennedy, in his message to Congress

on April 2, 1963, dealt with the cost of foreign aid programs and their need when he stated:

> The United States today is spending over 10 per cent of its gross national product on programs primarily aimed at improving our national security. Somewhat less than one-twelfth of this amount, and less than 0.7 per cent of our GNP, goes into the mutual assistance program: roughly half for economic development, and half for military and other short-term assistance. The contribution of this program to our national interest clearly outweigh its cost. The richest nation in the world would surely be justified in spending less than one per cent of its national income on assistance to its less fortunate sister nations solely as a matter of international responsibility; but inasmuch as these programs are not merely the right thing to do, but clearly in our national self-interest, all criticisms should be placed in that prespective. That our aid programs can be improved is not a matter of debate. But that our aid programs serve both our national traditions and our national interest is beyond all reasonable doubt.[11]

The Honorable David E. Bell, Administrator, Agency for International Development, at a hearing before the Joint Economic Committee, Congress of the United States, in 1963 addressed himself to the question of foreign aid impact upon the United States balance of payments when he stated:

> Today, fully eighty percent of A.I.D. funds are committed for the export of U. S. goods and services--not dollars. Of the less than twenty percent which will enter the balance of payments, all but a minor fraction will be spent in less-developed--not

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[11] John F. Kennedy, Message to Congress on Proposed Mutual Defense and Assistance Programs FY 1964, 2 April 1964, Published in "Proposed Mutual Defense and Assistance Programs FY 1964," U. S. Government Printing Office, Washington, D. C., April 29, 1963, p. 184.

> developed--countries. . . . The effect of existing A. I. D. procurement policies has been to increase A. I. D. financed exports of commodities and services sharply. . . . By confining an increasingly larger proportion of its commodity financing to United States exports, economic aid contributes to the United States merchandise exports. In calendar year 1962, United States merchandise exports totalled $20.5 billion and the surplus over imports was $4.3 billion. If the $2.3 billion in commodities financed by "economic aid" as broadly defined (including Public Law 480 surplus agriculture commodities as well as A. I. D. financed exports), are deducted, the surplus would be reduced to $2 billion.[12]

Looking beyond the balance of payments problem, there appears to be positive long-term gains to be won for the United States from the growth of economies abroad--the main purpose of the foreign aid programs. Prosperous nations buy more than the poor ones. United States exports to the "Marshall Plan" countries more than doubled from 1950 to 1962. However, United States exports to the less-developed countries rose by only fifteen per cent during the 1950's.

Although there was increasing criticism of the United States foreign aid programs, some of which appeared wholly justified, these aid programs generally did what they were expected to do. The aid programs were supported by four successive Presidents--Democratic and Republican alike--and indorsed by a bipartisan majority of ten

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[12] David E. Bell, "Mutual Defense and Assistance Programs," Remarks at the Hearings before the Joint Economic Committee, Congress of the United States, 88th Congress, 1st Session, Pursuant to Sec. 5(a) of Public Law 304 (79th Congress), Part I - Current Problems and Policies, U. S. Government Printing Office, Washington, D. C., 1963.

successive Congresses. The aid programs were and are necessary and hopefully will continue to recieve the support of the majority of the American people.

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[illegible] and hospitality will continue to receive the support
of the majority of the American people.

CHAPTER III

DEFENSE DEPARTMENT ACTIONS TO IMPROVE THE UNITED STATES BALANCE OF PAYMENTS

Up to as late as 1960, Department of Defense overseas activities were operating under procurement policies which encouraged maximum utilization of foreign sources for supplies and material needed to support their overseas operations.

In early 1952, the Department of Defense "Offshore Procurement Program" was implemented. The purpose of this program was to create or expand sources of supply abroad which would be nearer to the area where requirements are generated and consumed and to strengthen the mobilization base of our Allies and thus decrease their dependence upon the United States. By the end of 1956, over two billion dollars had been spent by the United States for procurement from foreign producers under this program.[1]

Complementary to the "Offshore Procurement Program" was the "Facilities Assistance Program," initiated in fiscal year 1954. The primary purpose of this program was to create local sources of supply for propellent and explosives production by furnishing equipment and technical

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[1] U. S. Department of the Air Force, Information and Guidance, Military Assistance Program, Washington, D. C., 1957, p. 18.

assistance for the construction of facilities in Western Europe for these purposes. The initial program was highly successful and was then broadened for the purpose of establishing centrally located facilities in Europe for the international cross-servicing and maintenance of material furnished under the Military Assistance Program.[2]

In addition to the "Offshore Procurement" and "Facilities Assistance" programs, which dealt primarily with major items of supply and material, overseas procurement activities were strongly encouraged to utilize foreign sources of supply to the maximum extent possible to satisfy their requirements for commercial "off-the-shelf" items required for normal day-to-day operations and maintenance.

These procurement programs and policies, coupled with (1) the expenditures by United States servicemen and civilians, employed by the overseas military installations, and their dependents on the local economies; (2) Department of Defense contributions to jointly financed and jointly used NATO facilities--such as air-fields, communication facilities and depots, generated gross military expenditures entering into the United States Balance-of-Payments of two billion one hundred million dollars average per year during the period 1950 thru 1956 and three billion one hundred million dollars average per year during the period 1957 thru 1960.[3]

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[2] Ibid., p. 19.

[3] U. S. Department of Commerce, Office of Business Economics, Balance of Payments Statistical Supplement Revised Edition, U. S. Government Printing Office, Washington, Pt. 4, p. 259.

Although studies for reducing overseas defense expenditures were being conducted within the Department Of Defense during the latter part of 1959 and early 1960, the first positive action towards reducing the defense contributions to the deficit in the United States balance-of-payments came on November 17, 1960, when President Dwight D. Eisenhower directed the Secretary of Defense to:

> Reduce and thereafter limit the number of dependents abroad of military and civilian personnel to a total of not more than 200,000 at any one time, which total shall be subject to annual review. This reduction shall be accomplished at the rate of not less then 15,000 per month commencing January 1, 1961, pursuant to such rules and regulations as the Secretary may prescribe and shall, to the maximum extent feasible, apply to dependents located in highly industrialized countries with strong currencies. Exceptions to the foregoing limitations shall require the personal authorization of the Secretary or Deputy Secretary of Defense.
>
> Take promptly all possible steps to reduce by a very substantial amount the expenditures, from funds appropriated to the military services and for the military assistance program, that are planned for procurement abroad during calander year 1961, by establishing a minimum amount by which such procurement shall be reduced.
>
> Prohibit the purchase of foreign goods by the non-appropriated fund activities related to the military services, except where exceptions to this prohibition are made under the personal authorization of the Secretary or Deputy Secretary of Defense.[4]

President Kennedy, immediately upon entering office, ordered a reappraisal of the balance-of-payment situation

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[4] U. S. President, 1952-1960 (Eisenhower), Directive by the President Concerning Steps to be Taken with Respect to the United States Balance of Payments, November 16, 1960, Federal Register, Vol. 25, No. 232, Washington, Wednesday, pp. 12219-12278, p. 12221.

with particular reference to the then outstanding order to reduce the number of dependents of Department of Defense Personnel overseas. On February 6, 1961, President Kennedy advised Congress that " . . . it has become clear that the present limitation on dependents was not the best way to accomplish this savings, and that this limitation was seriously hurting morale and recruitment in the armed forces."[5] He further advised Congress that the savings expected from the restriction of military dependents overseas could be made through other measures and therefore he had directed the Secretary of Defense to rescind the limitation on dependents and to put the other measures into effect immediately.

As subsequent action to the Presidential directives of November 16, 1960 and February 6, 1961, the Department of Defense implemented a series of actions to reduce the net adverse effect military expenditures were having upon the United States balance of payments. In directing these actions, the Secretary of Defense established a prime objective of the Department of Defense, the reduction of the net adverse balance of United States defense expenditures entering the international balance of payments by one billion dollars between fiscal years 1961 and 1963.[6]

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[5] U. S. President, 1961-1963 (Kennedy) Message to Congress on Balance of Payments and Gold, February 6, 1961, Congressional Quarterly Almanac, Vol. XVII, 1961.

[6] Charles J. Hitch, Assistant Secretary of Defense, Statement before the Subcommittee on International Exchange and Payments of the Joint Economic Committee, December 12, 1962, Pt. 2.2, p. 19.

He further established a long-term objective to reduce the total net adverse dollar outflow stemming from defense programs to one billion dollars by fiscal year 1966.

The Department of Defense's efforts to reduce overseas military expenditures can be divided roughly into the following areas: (1) the reduction of overseas expenditures for major equipment and supplies from the military function appropriations; (2) the reduction of overseas expenditures by individuals (United States military and civilian personnel and their dependents); (3) the reduction of overseas expenditures for the Military Assistance Program; and (4) the review of overseas bases and construction projects to preclude unnecessary foreign exchange costs.[7] Since the Presidential directive of November 16, 1960, a series of Department of Defense directives were issued in each of the above major areas, some modifying and/or superceding previous directives on the same subject. In many cases directives in one area are functionally related to directives in another area only by the fact that actions under these directives result in transactions entering into the United States balance-of-payments. For this reason, the various actions taken by the Department of Defense have been segregated for discussion under the major categories outlined above.

Overseas Expenditures for Major Equipment and Supplies

The first of a series of Department of Defense Directives dealing with procurement of supplies and services

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[7] *Ibid.*

to be procured and used outside of the United States was issued on December 16, 1960. This directive established as a minimum goal the reduction of sixty-five million dollars in planned foreign purchases during calendar year 1961. To meet this goal, guidelines were established for determining which purchases would no longer be purchased abroad:

> Requirements for supplies of foreign origin will be reviewed to determine whether domestic supplies can adequately fulfill the needs of the services.
>
> Where it is estimated that the cost of United States supplies or services (including transportation and handling costs) will not exceed the cost of foreign supplies or services by more than twenty-five percent, such proposed purchases shall normally be returned to the United States for award. Judgment should be exercised with respect to large purchases coming within this category involving the maximum differential.
>
> Future research and development programs planned abroad shall be reviewed to determine if United States firms or individuals possess the requisite qualifications to perform the research and development work but due consideration should be given to the interdependence of such research work being performed abroad with other joint programs of the United States and other governments.[8]

Exceptions were granted in this directive from the guidelines to allow: (1) emergency purchases; (2) purchases under one thousand dollars; (3) purchases of subsistence which were so fragile or perishable that their quality at the point of consumption would be impaired or destroyed if shipped from the United States; (4) purchases of supplies

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[8] U. S. Department of Defense, Office of the Secretary of Defense, "Supplies and Services to be Procured and Used Outside of the United States," Memorandum, to the Service Secretaries, Washington, D. C., December 16, 1960.

and services available only from foreign sources and for which there are no acceptable substitutes; (5) purchases made with excess foreign currencies held by the United States Treasury to the extent such purchases avoid an adverse effect upon the United States balance-of-payments; (6) purchases of supplies or services required to be made pursuant to a treaty or executive agreement; and (7) other purchases as specifically authorized by the Secretary of Defense.

The directive of December 16, 1960 was extremely broad in scope and with flexible terms. Apparently, the underlying intent of the directive was to give the military services sufficient latitude and discretion in establishing specific measures to accomplish the objective. For example, on the guideline for the purchase of supplies and services involving a price differential, the word "normally" was used leaving to service decision the returning of requirements where the cost differential was less than twenty-five per cent. Furthermore, the statement "to use judgment with respect to requirements involving the maximum differential" was interpreted by most overseas activities as giving substantial weight to budgetary consideration in connection with large purchases, even though the cost of the supplies or services in the United States (including transportation and handling costs) was within the twenty-five per cent differential. In addition, the directive was silent as to the level of authority necessary to make the various determinations (e.g., whether to buy United States or foreign when the requirement was large and the price differential was slightly below twenty-five per cent), required by the

directive. Accordingly, this authority was exercised by various individuals at different levels at overseas installations, each using his own interpretation of the directive.

Although it was anticipated that the directive of December 16, 1960 would easily meet the minimum objective of reducing planned overseas procurement by sixty-five million dollars, an analysis of departmental reports covering the first half of calendar year 1961, revealed that the goals were not being met. To provide a broader base for opportunities to reduce purchases from foreign suppliers, the directive was expanded on August 9, 1961,[9] to apply to proposed purchases to be made by purchasing offices located within the United States of supplies and services solely for use outside the United States, its possessions and Puerto Rico.

On July 16, 1962, the Secretary of Defense issued a revised directive governing the purchases of supplies and services for use outside the United States, its possessions, and Puerto Rico.[10] This revised directive closed most of the "loop holes" of the December 16, 1960 directive by: (1) providing that the procurement action would be restricted to domestic source end products or services of domestic concerns, when the estimated price of the requirement, delivered from United States sources, would not exceed $10,000; (2) providing that the procurement action would be restricted to domestic source end

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[9] Idem., August 9, 1962.

[10] Idem., July 16, 1962.

products or services of domestic concerns, when the estimated cost of the requirement was more than $10,000, but it was estimated that the cost of domestic source end products, or services of domestic concerns (including transportation and handling costs) would not be more than fifty per cent in excess of the cost of foreign supplies or services (including transportation and handling costs); and, (3) providing that in all instances where the estimated cost of a requirement was in excess of $10,000 and the estimated or actual cost of domestic source end products or services of domestic concerns would be more than fifty per cent in excess of the cost of foreign supplies or services, the requirement and supporting data would be submitted to the Secretary of Defense for determination whether to buy domestic end products or services of domestic concerns or foreign supplies or services.

In addition to outlining specific procedures governing the solicitation of bids and proposals for supplies and services to be used outside the United States, its possessions and Puerto Rico, the July 16, 1962 directive made substantial changes in the exceptions previously allowed from the prescribed procurement policy on applying the price differential in evaluating bids or proposals on domestic end products or the services of domestic concerns. These changes included: (1) the authority to accomplish small purchases in overseas areas without cost determinations between domestic and foreign products or services was reduced from one thousand to five hundred dollars per transaction; (2) a limitation of ten thousand dollars was placed upon the use of the exception allowing procurement from foreign sources of

requirements under compelling emergencies; (3) the exception allowing the procurement of perishable subsistence items (such as fresh vegetables, fresh fruit, milk, etc.) which are of such a nature that their quality at the point of consumption would be destroyed or significantly impared if shipped from the United States remained; however, the making of this determination was restricted to the Commanders of specific military commands and forces with authority to redelegate this authority to individuals at lower echelons only for those procurements which were estimated not to exceed ten thousand dollars; and (4) the authority to make the determination--that the requirement was of a nature that could be filled only by foreign suppliers or service concerns--was greatly curtailed by specifying that the Commanders of military commands would make the determination for procurements estimated not to exceed one million dollars (with power of redelegation of the determination authority to lower echelons for requirements estimated not to exceed ten thousand dollars); that the Departmental Secretaries or the Director, Defense Supply Agency, as appropriate, would make the determination on requirements estimated to exceed one million dollars but not more than three million dollars; and that the Secretary of Defense or the Deputy Secretary of Defense would make the determination for all procurements estimated to exceed three million dollars.

The results of procurements in fiscal year 1963, under guidance contained in Secretary McNamara's directive of July 16, 1962, as amended, are reflected in the following tables.

Table I shows that a total of four hundred and

seven million dollars in supplies, services and construction was awarded to foreign contractors covering requirements for use outside of the United States, its possessions and Puerto Rico. Compared with contract awards made in fiscal year 1962, there is indicated a decrease in contract awards amounting to seventy-nine million dollars or sixteen per cent.

TABLE I.--Foreign Origin Procurement for use outside the U. S.[a] (New Contract Awards) Fiscal Year 1963 (Value in millions of dollars)

Country	Total	Awards of Less Than $10,000	Awards of $10,000 or More
Total, all countries	407	96	311
Western Europe	287	72	215
Japan	83	16	67
All other	37	8	29

[a] Excluding Military Assistance Program, petroleum, non-appropriated fund procurements and purchases made in Korea and Canada. Source: Directorate for Statistical Services, OSD.

Table II shows the estimated amount of procurement normally placed with foreign sources, but returned for purchase in the United States.

Table III shows the cost of making these purchases in the United States. All told, there was a total of ninety-six million dollars in domestic contracts whose estimated cost would have been seventy-five million dollars in foreign contracts. The added cost to Department of

Defense was twenty-one million dollars or twenty-eight per cent more than the estimated foreign costs.

TABLE II.--Procurement normally placed with Foreign Sources but obtained from Domestic Sources (Fiscal Year 1963) (Value in millions of dollars)

Country[a]	Total	Awards of Less Than $10,000[b]	Awards of $10,000 or More[b]
Procured from domestic source - total	96.4	15.2	81.2
Western Europe	81.0	10.6	70.3
Japan	7.9	3.3	4.5
Canada	.6	0.0	.6
All other	6.9	1.2	5.7

[a] Foreign Source with lower price.

[b] Detail may not add to totals due to rounding.

Source: Directorate for Statistical Services, OSD.

TABLE III.--Added cost of returning Procurement to the United States (Fiscal Year 1963) (Value in millions of dollars)

Country[a]	Total	Awards of Less Than $10,000[b]	Awards of $10,000 or More[b]
Added cost - total	20.9	2.1	18.8
Western Europe	18.3	1.3	17.0
Japan	1.7	.6	1.1
All other	.8	.1	.7

[a] Foreign source with lower price.

[b] Detail may not add to totals due to rounding.

Source: Directorate for Statistical Services, OSD.

Table IV shows the four hundred and twenty-four million dollars of new contracts for foreign origin supplies and services, broken down by the various exceptions specified in the July 16, 1962 directive which permitted procurements abroad. Requirements which could be filled only from foreign sources amounted to one hundred and eighty million dollars, or forty-two per cent of the total exceptions. Perishable subsistence purchases amounted to seventy-three million dollars, or seventeen per cent of total exceptions. Purchases made pursuant to a treaty or executive agreement between governments amounted to sixty-two million dollars, or fifteen per cent of total procurements under the exceptions. Purchases under ten thousand dollars each made under the "price differential exception" totalled fifty million dollars, or twelve per cent of total exceptions. The "all other" category consists of purchases, in excess of ten thousand dollars each for which the estimated domestic cost was over fifty per cent that of foreign cost, and which amounted to forty-nine million seven hundred thousand dollars, or thirteen per cent of total exceptions.

As previously stated in 1962, the Secretary of Defense set as the long-range goal of the Department of Defense a reduction in the net adverse effect of United States defense expenditures entering the balance-of-payments to one billion by fiscal year 1966. The question, however, arose as to what further action could be taken in the area of overseas expenditures for major equipment and supplies to meet the objective? Further, what would be the net effect of any such action upon the Department

of Defense? To attempt to answer these questions it was necessary to analyze the foreign origin procurements made during fiscal year 1963 under the authorized exceptions of the July 16, 1962 directive.

TABLE IV.--Foreign Origin Procurements for use outside United States by Exceptions permitted in July 16, 1962 Directive (New Contract Awards)[a] (Fiscal Year 1963) (Value in millions of dollars)

Exception	Total
Exceptions, total	423.6
Treaty or Executive Agreement	62.2
Procurements of $500 or less	26.9
Emergency procurements under $10,000	1.7
Perishable subsistence	73.0
Requirements can be filled only by foreign supplies or services	179.9
Cuban crisis	.5
Other purchases under $10,000	22.8
Excess foreign currencies	6.8
All other	49.7

[a] Excluding Military Assistance Program, petroleum, nonappropriated funds procurement, and construction.
Source: Directorate for Statistical Services, OSD.

Requirements which could be filled Only with Foreign Supplies or Services

According to the data contained in Table IV, requirements which could be filled only from foreign sources amounted to one hundred eighty million dollars, or forty-two per cent of total procurements. Almost all of

the requirements purchased under this exception fall into one of the following categories of requirements: (1) utilities, including gas, water, electricity, steam, sewage, refuse collection and disposal; (2) communication services; (3) port handling and stevedoring services; (4) maintenance and repair of, and procurement of spare parts for, foreign manufactured vehicles, equipment, machinery and systems; (5) packing and crating services; (6) laundry and dry cleaning; (7) coal handling and storage; (8) industrial gases; and, (9) transportation services. Everyone of these general areas, with the exception of "(4)" above, were directly related to the support of United States military forces on any installation whether in the United States or in a foreign country. The nature of these supplies and services are such that they cannot be obtained from other than the source located in the general vicinity of the installation. Further, a high portion of the cost for providing these supplies and services is composed of overhead and indirect costs and therefore the total cost does not fluctuate upward or downward in direct relation to the strength of the military force utilizing these supplies and services.

With respect to general area "(4)" above, almost all of the expenditures are for fixed equipment, machinery and systems of the installation. To replace this equipment with United States manufactured equipment, machinery or systems would usually necessitate the execution of alteration and minor construction contracts which would generate greater foreign exchange costs than were being incurred in the procurement of maintenance and repair services or spare parts for the foreign equipment, machinery

and systems. It therefore can be concluded that costs under this exception would continue to occur and would remain constant in direct relation to the number of overseas installations maintained by the Department of Defense.

Perishable Subsistence

Perishable subsistence purchases during fiscal year 1963, totalled seventy-three million dollars and represented seventeen per cent of total expenditures under the exceptions. Purchases in this category which exceeded ten thousand dollars per transaction were required to be approved by a Major Overseas Commander. It therefore can be assumed that these purchases represented the minimum requirements needed to provide balanced diets to military troops and dependents and that possible substitutes of products of United States origin, not susceptible to deterioration or spoilage while in shipment from the United States, were considered rejected.

Although foreign exchange costs in this category could be reduced by transporting perishable subsistence of United States origin by military jet aircraft, the cost to military appropriations, generated by such operations, would be three to five times as great as the costs of procuring this subsistence in foreign countries. Further, a sizable portion of the "airlift" capability would have to be diverted to the accomplishment of this task.

It therefore can be concluded that expenditures in this category would remain constant in direct relation with the size of the United States military forces maintained

abroad.

Treaty or Executive Agreement

Procurements pursuant to a treaty or executive agreement between governments amounted to sixty-two million dollars, or fifteen per cent of total expenditures under the exceptions.

Savings in this area were generally not subject to control by the Department of Defense. Until such time as new treaties or executive agreements were negotiated and executed between the United States and the foreign governments, reductions in this category would be minor and of little significance in meeting the objectives of the Department of Defense.

Procurements of $500 or Less

The twenty-seven million dollars expended for purchases of five hundred or less per transaction represented six per cent of total expenditures under the exceptions. Supplies and services procured under this exception usually were (1) emergency purchases, subsistance, sole source, etc., or (2) "one-time" or "sporadic" requirements which even though available from sources in the United States, were not recurring requirements and therefore did not justify the costs associated with the maintenance of stocks of the items at the overseas installation.

The requirements under this exception were usually procured under one of the simplified purchase procedures (Imprest Funds, Blanket Purchase Agreements, etc.), which were designed to provide means for

accomplishing small dollar purchases with considerably less administrative effort and cost than that usually associated with the more complex procurement methods.[11]

The abolishment of this exception to purchase small requirements abroad, would (1) in the case of the first category of items and services, result in the requirements being purchased from foreign sources under one of the other exceptions available; or, (2) in the case of the supplies in the second category, result in increased Department of Defense appropriation cost because stocks of these items would have to be established and maintained to allow for the delays associated with the requisitioning of these requirements from the United States.

In light of the above, it can be concluded that the retention of this exception was appropriate and purchases thereunder would continue as long as forces are maintained abroad.

Other Purchases Under $10,000 and "Other Purchases"

The combined expenditures under the exceptions "Other Purchases under $10,000" and "Other Purchases" amounted to seventy-two and a half million dollars and represented approximately seventeen per cent of total expenditures under all exceptions. These purchases consisted of requirements which were available from United States sources but because the domestic cost was over

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[11] U. S. President, 1961-1963 (Kennedy), Message to Congress on Balance of Payments and Gold, February 6, 1961, Congressional Quarterly Almanac, Vol. XVII, 1961.

fifty per cent higher than the foreign costs, determinations were made to satisfy the requirements through purchase from foreign sources.

By requiring all of these requirements to be procured from United States sources or by increasing the price differential to be added to domestic prices for evaluation purposes, a substantial dollar amount would be eliminated from the United States balance-of-payments.

According to statistics maintained by the Department of Defense, the additional costs incurred by making purchases from domestic sources under the fifty per cent price differential rule totalled twenty-one million dollars or twenty-eight per cent more than the estimated cost of foreign source items. The twenty-eight per cent represented the average increased cost of individual requirements where the price differential was from one per cent to forty-nine per cent greater than the foreign cost.

If the purchases made during fiscal year 1963 from foreign sources under the fifty per cent differential rule were to have been purchased from domestic sources, the added costs to the Department of Defense would have been at least fifty per cent (thirty-seven million dollars) greater than they were when purchased from foreign sources.

Although it was recognized by the President of the United States that some increased budgetary costs would accrue by virtue of the reduction of dollar flow abroad and the Congress had been apprised of the "cost differential" rules being applied in the purchase of requirements for use outside the United States,[12] there was some question as to

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[12] U.S. Department of Defense, Office of the Secretary of Defense "Supplies and Services to be Procured and Used Outside of the United States," Memorandum to the Service Secretaries, Washington, D. C., December 16, 1960.

what extent these increased costs would be tolerated in defense appropriations before other actions, outside the "Government Account" sector, would be considered more appropriate to curb dollar outflow.

Construction of New Facilities/Maintenance, Repair, Alteration of Existing Facilities

The initial effort to reduce overseas military expenditures for construction of real property and the maintenance, repair and alteration to existing real property was that made on December 16, 1960 when the Secretary of Defense directed that "No further contracts for the construction of family housing and related facilities, such as schools chapels, hospitals, and commissories would be awarded pending rejustification and specific approval from the Office of the Assistant Secretary of Defense (Property and Installations)."[13]

On July 12, 1962, the Secretary of Defense announced a plan to reduce the foreign exchange cost of overseas construction by the use of techniques such as prefabricated housing, constructed in the United States and transported to overseas areas.[14] Again on November 27, 1962, the Secretary of Defense announced a goal of

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[13] U. S. Department of Defense, Statement by Secretary of Defense at Press Conference, Washington, D. C., July 16, 1962.

[14] U. S. Department of Defense, Office of the Secretary of Defense, "Real Property Maintenance, Repair, Alteration, and Minor Construction Accomplished by Contract," Memorandum to the Service Secretaries, 27 November 1962.

reducing by twenty-five per cent the fiscal year 1963 estimated expenditures for maintenance, repair, alteration and minor construction of real property overseas. This goal would be accomplished by: (1) procuring the maximum amount of materials and supplies in the United States to be supplied contractors as a replacement for those now being furnished by the contractors; and, (2) restricting alteration and minor construction projects performed by contract to those urgently required for the support of the military mission. To insure that the objective was being met, a rule was set forth which required that all contracts for maintenance estimated to exceed $100,000 or repair work in the $50,000--$100,000 cost category would be approved by the Secretary of the Military Department or his designee. Further, any requirement for repair work estimated to exceed $100,000 would require approval in advance by the Assistant Secretary of Defense (Installations & Logistics) or his designee.[15]

The restraining orders on the expenditures of funds overseas for construction of new facilities or for the rehabilitation and maintenance of existing facilities were, when considered by themselves, negative in nature and were of little benefit in reducing the balance of payments deficits. There is little question that as long as military units are located at specific overseas facilities, needs will exist for new facilities to house and support the military members and their dependents. However, when these restraining orders are considered in

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[15] *Ibid*.

light of other actions initiated, they represent a major factor in the overall Department of Defense overseas expenditure reduction program. One such supplementary action involves the consolidation and/or elimination of overseas facilities, announced by the Secretary of Defense on July 16, 1962:

> A comprehensive review of the requirements for each of our foreign military bases and installations occupied by United States military services has been undertaken. As a part of this over-all review, a special study group visited selected countries in Western Europe to determine the feasibility of combined utilization of depots with our Allies, as well as to ascertain the possibilities for a reduction, elimination or consolidation of headquarters, training and major logistical support activities.[16]

To construct new facilities or the rehabilitation of existing facilities at locations which could subsequently be declared "nonessential" in overall defense planning, would not only result in unnecessary foreign exchange costs but would subject the Department of Defense to criticism for inadequate planning resulting in unwarrented budgetary expenditures.

Various newspaper articles from July 16, 1962 to 1964 tended to reflect the success of the consolidation/ elimination of overseas facilities program:

> President John F. Kennedy said Thursday the United States has withdrawn some support troops from Europe in the past few months but there is no present plans to bring home any U. S. combat forces. He said there

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[16] U. S. Department of Defense, Office of the Secretary of Defense, "Supplies and Services to be Procured and Used outside of the United States," Memorandum to the Service Secretaries, Washington, D. C., July 16, 1962.

merely had been a "lessening of logistic forces" but the action had not at all lessened the number of our combat troops.[17]

The 4085th Wing of the U. S. Strategic Air Command is pulling out of this high Arctic community of Frobisher Bay, Baffin Island, Northwest Territories.[18]

Canada and the United States have agreed to abandon twenty-eight of the smaller stations of the Distant Early Warning Line radar chain. About 123 Canadians and 60 U. S. citizens will be affected.[19]

The United States is expanding its military traffic through the ports of Antwerp and Rotterdam and it is reported that U. S. supply lines are to be shifted out of France entirely to the Belgian and Dutch ports. U. S. Authorities state the intention is to phase out gradually the U. S. supply lines across France . . . Gilpatric said the Pentagon planned to shrink its housekeeping and logistical troops in France and other areas where the dollar drain is heavy.[20]

The Pentagon announced today that it would shortly begin cutting back the strategic B47 bomber forces stationed in Britain. The cutback, long pending, will result in the evacuation of two B-47 bases, which will be turned over to the Royal Air Force. The assignment of 2,659 USAF officers and men will be affected.[21]

United States to cut Air Force in Japan by 3500 military personnel and 2000 dependents. B57 Bombardment Wing will be deactivated and Tactical Air Command fighter squadrons will be rotated into Misawa Air Base

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[17] Washington Post, 15 February 1963.

[18] Philadelphia Inquirer, 15 July 1963.

[19] The Globe and Mail, Toronto, Canada, 16 July 1963.

[20] Washington Post, 21 July 1963.

[21] Baltimore Sun, 12 November 1963.

from other bases in the world to avoid leaving any gap in Northern Japan's air defenses.[22]

The consolidation and/or elimination of overseas facilities without materially reducing the United States defense capabilities, resulted in: (1) the return of redundant logistic forces to the United States; (2) the transfer of United States logistic supply points and operations to countries where the foreign exchange costs were reduced or eliminated through "country-to-country offset agreements;" and/or (3) the withdrawal of older weapon systems overseas with mission responsibilities assigned to more advanced weapon systems located within the United States, appeared to be the most direct means in attempting to reduce the military deficits in the United States balance-of-payments.

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[22] _The Globe and Mail_, Toronto, Canada, 31 December 1963.

CHAPTER IV

DEPARTMENT OF DEFENSE BALANCE OF PAYMENTS: A POTPOURRI

Military Assistance Program

Insofar as the Military Assistance Program was concerned, the adverse United States balance-of-payments received its first major consideration with the passage of the Foreign Assistance Act of 1961. Section 604 (a) of this Act prescribes:

> Funds made available under this Act may be used for procurement outside the United States only if the President determines that such procurement will not result in adverse effects upon the economy of the United States or the industrial mobilization base, with special reference to any areas of labor surplus or to the net position of the United States in its balance of payments with the rest of the world, which outweigh the economic or other advantages to the United States of less costly procurement outside the United States. . . .[1]

On October 18, 1961, the President of the United States determined in pertinent part, under Section 606 (a) of the Act that:

> I also hereby direct that funds made available under the Foreign Assistance Act of 1961 for military assistance programs not be used for procurement outside the United States except to procure items required for military assistance which are not produced in the United States, to make local purchases for administrative purposes, and to use

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[1] U. S. Department of Defense, Directive No. 2125.1, "Military Assistance Program Offshore Procurement (MAP/OSP)," December 5, 1963.

> local currency available for military assistance purposes. Upon certification by the Secretary of Defense, however, that exclusion of procurement outside the United States would seriously impede attainment of military assistance program objectives, the Secretary of Defense may authorize exceptions to these limitations.[2]

The Department of Defense implementation of Section 604 (a) of the Foreign Assistance Act of 1961 and the President's directive of October 18, 1961, was by Department of Defense Directive 2125.1, dated January 2, 1962, the act which authorized the use of Military Assistance Program funds for offshore procurements, subject to certification by the Assistant Secretary of Defense that the exclusion of procurement outside the United States would seriously impede the attainment of Military Assistance Program objectives, for the following additional purposes: (1) Government-to-Government cost-sharing projects under the Mutual Weapons Development Program; (2) Government-to-Government commitments involving cost-sharing production projects, when MAP is an integral part of the cost-sharing commitment; (3) Procurement required to support overriding foreign policy objectives as approved by the Secretary of State; and, (4) Procurement required to support overriding military logistical considerations which are important to the defensive capabilities of the Free World.[3]

On December 5, 1963, the Department of Defense

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[2] *Ibid*.

[3] U. S. Department of Defense, Directive No. 2125.1, "Military Assistance Program Offshore Procurement (MAP/OSP)," December 5, 1963.

issued a revised Directive 2125.1. The major changes included: (1) a requirement that all Military Assistance Program procurements contemplated to be made outside the United States, its possessions and Puerto Rico, which were estimated to exceed three million dollars would be referred to the Secretary of Defense for determination on a case by case basis; (2) a provision that Military Assistance Program procurement of supplies and services (including construction materials, but excluding construction services) to be used outside the United States, its possessions and Puerto Rico, would be restricted to domestic source end products, or services of domestic concerns located in the United States if the price delivered from the United States sources would not exceed ten thousand dollars; (3) a provision that procurements which exceed ten thousand dollars would be restricted to United States domestic sources if the estimated domestic price was estimated to be not more than fifty per cent in excess of the cost of Foreign supplies or services; (4) a requirement that all procurements in excess of ten thousand dollars where the domestic price exceeds the fifty per cent differential, would be referred to the Office of the Secretary of Defense for determination and approval; (5) a limitation on the use of Military Assistance Program funds for new commitments on government-to-government cost-sharing projects; and (6) authority to continue the use of Military Assistance Program funds for United States contributions to the budgets of International Military Headquarters and to NATO projects.[4]

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[4] _Ibid_.

issued a revised directive 2110.1. The major changes included: (1) a requirement that all military assistance program procurement contemplated to be made outside the United States, its possessions and Puerto Rico, which were estimated to exceed three million dollars would be referred to the Secretary of Defense for determination on a case by case basis; (2) a provision that military assistance program procurement of supplies and services (including construction materials, but excluding construction services) to be used outside the United States, its possessions and Puerto Rico, would be restricted to domestic source end products, or services of domestic concerns located in the United States if the price delivered from the United States sources would not exceed ten thousand dollars; (3) a provision that procurements which exceed ten thousand dollars would be restricted to United States domestic sources if the estimated domestic price was estimated to be not more than fifty per cent in excess of the cost of foreign supplies or services; (4) a requirement that all procurements in excess of ten thousand dollars where the domestic price exceeds the fifty per cent differential, would be referred to the Office of the Secretary of Defense for determination and approval; (5) a restriction on the use of military assistance program funds for the commitments on government-to-government cost-sharing projects; and (6) authority to continue the use of military assistance program funds for United States contributions to the budgets of International Military Headquarters and to SHAPE projects.[9]

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[9] Ibid.

Overseas Expenditures by Individuals

On September 30, 1960, there were 529,000 United States military personnel and 21,000 United States Department of Defense civilian employees assigned in foreign countires. These military and civilian personnel were accompanied by 487,000 dependents.[5]

The Presidential directive of November 16, 1960, called for a reduction in the number of dependents overseas, at a rate of 15,000 per month commencing January 1, 1961, to a total of not more than 200,000.[6]

According to the schedule established by the Presidential directive, a total of nineteen months would be required to reduce the 487,000 dependents to the maximum of 200,000. The reduction of dependents overseas would result, according to Department of Defense calculations, in a balance-of-payments savings of eighty-three dollars per dependent/month, thereby resulting in balance-of-payments savings totaling $97.1 million in calendar year 1961; $257.7 million in calendar year 1962; and $285.0 million in calendar year 1963.[7]

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[5] U. S. Department of Defense, Office of the Secretary of Defense, Letter to the President of the United States, 1 February 1961.

[6] U. S. President, 1952-1960 (Eisenhower), Directive by the President Concerning Steps to be Taken with Respect to the United States Balance of Payments, November 16, 1960, Federal Register, Vol. 25, No. 232, Washington, Wednesday, pp. 12219-12278, p. 12221.

[7] U. S. Department of Defense, Office of the Secretary of Defense, Letter to the President of the United States, 1 February 1961.

The Military Services issued the initial directive to their activities, announcing the implementation of that portion of the directive dealing with the limitation of dependents, on November 18, 1960. Immediate action was directed to: (1) discontinue overseas movement of dependents who were not in receipt of a reservation scheduling overseas travel prior to February 1, 1961; (2) allow those individuals not selected for overseas assignment prior to November 18, 1960, who have submitted a "volunteer statement for overseas duty," to withdraw such statement; (3) discontinue issuance of dependent travel authorizations; (4) discontinue granting authorizations to extend beyond the normal overseas tour to any military personnel accompanied by dependents.[8]

On November 23, 1960, the Overseas Military Commands were directed to hold in abeyance all actions to incure additional obligations and commitments of funds for the procurement of new/replacement furniture, for the rehabilitation and/or improvement of government owned family quarters and for the acquisition of new leased family units.[9]

That portion of the President's directive, dealing with the prohibition against the resale of foreign goods in nonappropriated fund activities, was implemented by the

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[8] U. S. Department of Air Force, All Major Command Message 1414/60, dated 18 November 1960.

[9] U. S. Department of Air Force, All Major Command Message 1427/60, dated 23 November 1960.

The military services issued the initial directive to their activities, concerning the implementation of this portion of the directive dealing with the limitation on dependents, on November 18, 1960. Immediate action was directed to: (1) discontinue overseas movement of dependents who were not in receipt of a transportation authority for overseas travel prior to February 1, 1961; (2) allow those individuals not selected for overseas assignment prior to November 16, 1960, the time permitted a "voluntary unaccompanied tour," to volunteer with statement; (3) discontinue issuance of dependent travel authorizations; (4) discontinue granting authorizations to extend beyond the normal overseas tour to any military personnel accompanied by dependents.[3]

On December 21, 1960, the Continental Military Commands were directed to hold in abeyance all actions to commence additional estimates and commitment of funds for the procurement of [illegible] facilities, for the rehabilitation and improvement of [illegible] family quarters and for the acquisition of new leased family units.[4]

This portion of the President's directive, dealing with the prohibition against the resale of foreign goods in nonappropriated fund activities, was implemented by the

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[3] U. S. Department of Air Force, All Major Commands Message (AFA No. [illegible], dated 18 November 1960).

[4] U. S. Department of Air Force, [illegible] Major Command Message, 1407/SC, dated 22 December 1960.

the Secretary of Defense on November 25, 1960.[10]

During December 1960 and January 1961, the Military Services conducted numerous studies on the effects the restriction on dependents overseas would have upon military personnel. On February 1, 1961, the Deputy Secretary of Defense sent a letter to the President of the United States advising him of the adverse effects on the morale and career incentives of military personnel generated by the restrictions on the movement of dependents overseas. Also in this letter, the Deputy Secretary of Defense outlined various programs which could be implemented, to reduce the expenditures overseas by military and civilian personnel and their dependents, that would generate greater savings than that contemplated by the restriction on dependents overseas.[11] On February 1, 1961, President Kennedy recinded the Presidential Directive of November 16, 1960, as it dealt with the limitation of dependents overseas, and directed that the alternate methods and programs to reduce overseas expenditures be implemented immediately.[12]

The Department of Defense actions to reduce overseas expenditures by military and United States civilian

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[10] U. S. Department of Defense, Office of the Secretary of Defense, "Nonappropriated Fund Activities of Department of Defense," Memorandum to the Service Secretaries, Washington, D. C., 25 November 1960.

[11] U. S. Department of Defense, Office of the Secretary of Defense, Letter to the President of the United States, 1 February 1961.

[12] U. S. President, 1961-1963 (Kennedy), Message to Congress on Balance of Payment and Gold, February 6, 1961, Congressional Quarterly Almanac, Vol. XVII, 1961.

personnel and their dependents fell into three separate categories. One category dealt specifically with ways and means to change the spending and saving habits of the individuals abroad. Another category dealt with the operations of Nonappropriated Fund Activities with a view of improving the services offered so as to satisfy the minimum needs of overseas personnel and thereby reduce the dollar expenditures by individuals in the local economies. The third category involved actions to reduce to an absolute minimum our military and civilian forces overseas, consistent with our overseas military commitments, without degrading the effectiveness of our military strength. For the purpose of clarity and simplicity, the various actions taken by the Department of Defense in the area of individual expenditures have been grouped for discussion under the three categories mentioned above.

Actions to Change Spending and Saving Habits of Individuals

The initial action in this category was taken on March 6, 1961, with an objective to reduce expenditures by individuals abroad by $75 to $110 million during calendar year 1961. Because there were slightly over one million individuals (military members, United States citizen civilian employees and dependents of both) abroad, an average reduction in spending of seventy-five to one hundred ten dollars per year per capita would be required to meet this objective. In this action, the military departments were directed to: (1) initiate an extensive education process to point out the position of the United personnel and their dependents fall into three separate categories. One category dealt specifically with ways and means to change the spending and saving habits of the individuals served. Another category dealt with the operations of nonappropriated fund activities with a view of improving the services offered so as to satisfy the maximum needs of overseas personnel and thereby reduce the dollar expenditures by individuals in the local economies. The third category involved actions to reduce to an absolute minimum our military and civilian forces overseas, consistent with our overseas military commitments, without degrading the effectiveness of our military strength. For the purpose of clarity and simplicity, the various actions taken by the Department of Defense in the area of individual expenditures have been grouped for discussion under the three categories mentioned above.

Actions to Change Spending and Saving Habits of Individuals

The initial action in this category was taken on March 6, 1961, with an objective to reduce expenditures by individuals abroad by $75 to $150 million during calendar year 1961. Because there were slightly over one million individuals (military members, United States citizen civilian employees and dependents of both) abroad, an average reduction in spending of seventy-five to one hundred and fifty dollars per year per capita would be required to meet this objective. In this action, the military departments were directed to: (1) initiate an intensive education program to point out the position of the United

States in the international balance of payments and the action the individual may take which would contribute to a solution of the problem; (2) institute a voluntary program for reduction of individual expenditures for foreign goods to items which--

> Are purchased in an exchange outlet or other approved United States military operated resale activity, and then only to goods for which a real need exists. Are required for the use of the individual or his household incident to his duty overseas and a reasonable substitute can not be procured from an exchange outlet or from the United States. If not covered under above, do not exceed a total cost of one hundred dollars per year per individual overseas;[13]

(3) encourage and promote a savings program to the end that there would be an average one hundred dollars additional savings per year for each individual overseas.

To supplement the voluntary savings program, the Department of Defense imposed a prohibition upon the transportation at government expense of foreign made motor vehicles purchased by Department of Defense personnel or their dependents. The only exceptions to this prohibition were the fact that the car was owned or on order on or before March 6, 1961, the date of the order establishing the prohibition, or when it had been established that adequate facilities did not exist for the maintenance and repair of motor vehicles produced and assembled in the United States. Further, the Department of Defense took no action to urge extension of the Act of December 5, 1942

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[13] U. S. Department of Defense, Office of the Secretary of Defense, "Overseas Expenditures Reduction Program--Individual," Memorandum to the Service Secretaries, Washington, D. C., March 6, 1961.

which expired on June 30, 1961. This Act offered the entry, free of custom charges, of bonafide gifts from members of the Armed Forces of the United States to the extent of fifty dollars in any shipment. After expiration of the Act, the ten dollar free entry for gifts available to tourists was applicable to members of the United States Armed Forces.

Many individuals consider the voluntary savings programs of little or no benefit in reducing overseas expenditures by Department of Defense personnel and their dependents. They actually claim that the environment and social conditions associated with most overseas assignments (where dependents are allowed) were such that service personnel were induced to spend rather than save. In support of this position, this group usually cites the following examples:

1) The average military family of five or six, located in almost any part of the United States, must exercise considerable planning in managing its financial matters. The subject of "Help" to the housewife with household tasks and taking care of the children is not even considered except on special occasions. In contrast, this same family in many overseas locations is able to obtain "domestic help" on a full time basis for about the same costs as "once a week" help in the United States. Even though the "once a week" help was not utilized while within the United States, once overseas, who would not expend this nominal cost to give the wife a well deserved vacation from these household chores?

2) Most American families can only dream of an extended trip to a foreign country. Only a very small

percentage of these families realize such a dream in their life time. This factor has a direct bearing upon military families assigned overseas. The thought--"we may never be able to afford a vacation to this area"--tends to stimulate extended travel and vacations, not only in the country of assignment, but to all surrounding countries as well. The cumulative costs of such vacations quite often exceeded current earnings and were financed from past savings.

3) In a large number of overseas areas, Department of Defense members were required to utilize their own personal household goods and effects at their overseas location. During overseas tours, the members and families were exposed to high quality household goods at prices greatly reduced from prices of comparable merchandise in the United States or at prices comparable to United States "mass produced" merchandise of sometimes inferior quality. Because of this, military members tended to postpone normal replacement purchases while in the United States in anticipation of an overseas assignment; or, accomplish earlier disposal of still functionally satisfactory household goods and replacement with a purchase in the overseas area prior to rotation back to the United States. As a result, the expenditures by military members for household goods while overseas greatly exceeded the normal annual expenditures in this category while in the United States.

On the other hand, there are those officials and individuals who, while agreeing to the increased expenditures of military members on overseas tours, point to numerous statistics which: (1) clearly point out the

benefits of extended travel in the broadening of the education of military members; thus, preparing them to assume positions of greater responsibility within the Department of Defense; (2) stress the importance of "meeting the people" of our Allies to learn their customs, traditions and problems thereby resulting in a better basis for cooperation and understanding during war-time periods; (3) reflect the rapid attrition rate of household goods subjected to frequent moves. As such, it is necessary from a purely economic point of view, for military members to procure better quality merchandise to withstand this abnormal wear and tear.

Nonappropriated Fund Activities of the Department of Defense

That portion of the Presidential Directive of November 17, 1960, which prohibited the purchase of foreign goods by nonappropriated fund activities, was implemented by the Department of Defense on November 25, 1960. In this implementation, interim authority was granted to procure items of subsistence and other items which could not be immediately procured from the United States and it was determined that such items were essential to the health and welfare of personnel of the Department of Defense and their dependents.[14] In addition, this implementation established procedures for the submission of requests for exception under the Presidential Directive.

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[14] U. S. Department of Defense, Office of the Secretary of Defense, "Nonappropriated Fund Activities of Department of Defense," Memorandum to the Service Secretaries, Washington, D. C., 25 November 1960.

[illegible]

[illegible]

[illegible]

[illegible]

During the next ten months, a series of exceptions were granted from the provisions of the Presidential Directive as it related to the purchase of foreign goods by nonappropriated fund activities. These included:

1) December 6, 1960--authority was granted to purchase foreign perishable goods, beverages and similar items for consumption on the premises.[15]

2) December 6, 1960--authority was granted to purchase foreign goods for other than resale provided it has been determined that goods manufactured in the United States, serving the same functional purpose, were not available.[16]

3) December 22, 1960--nonappropriated fund activities located in Canada and Mexico were exempted from the provisions of the directive. Some of the primary factors which had a bearing upon the issuance of this exception were the economic ties and contiguous borders between the United States and these countries; the exempted status of dependents in both Canada and Mexico; and, the common interest in providing for the common defense.[17]

4) January 18, 1961--authority was granted to purchase the following goods for resale: (a) goods for which there are no acceptable substitutes of United States manufacture and which are required to operate and/or maintain customer owned equipment such as 220v/110v transformers, bulbs, sockets, and accessories; (b) infant

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[15] Idem., 6 December 1960.

[16] Ibid.

[17] Idem., 22 December 1960.

caskets; (c) distinctive unit ensigna; (d) soft drinks; (e) printed matter such as maps, postcards, magazines, newspapers, travel books, etc.; and, (f) items for use in connection with hobby craft shop and craft programs of the military services.[18]

5) February 2, 1961--nonappropriated fund activities located in the Republic of Korea were authorized to purchase for resale goods which were produced or manufactured in the Republic of Korea. Reasons cited as justification for this exception were: (a) favorable effect of dollar earnings on the Korean economy; (b) the relative small impact of nonappropriated fund purchases of Korean goods on the balance-of-payments problem; and, (c) the close economic, military and political associations and relationships between the United States and the Republic of Korea.[19]

6) February 27, 1961--authority was granted to purchase foreign goods in countries where the United States Treasury held large accumulated balances of local currency. All purchases made under this authority were required to be payable in foreign currencies rather than United States dollars.[20]

7) June 6, 1961--authority was granted to: (a) make emergency purchases; (b) make purchases pursuant to treaty or executive agreements; (c) purchase foreign goods for other than resale wherein it is estimated the cost of United States goods serving the same functional purpose

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[18] _Idem_., 18 January 1961.

[19] _Idem_., 2 February 1961.

[20] _Idem_., 27 February 1961.

(including transportation and handling costs) would exceed foreign costs of foreign goods by more than twenty-five per cent; (d) purchase foreign high octane gasoline, kerosene, and heating and cooking fuels for resale which are not otherwise available from appropriated fund stocks; (f) purchase automobile parts for American-made cars from foreign sources where supplies of American manufacturers are not available from either bonded warehouses or foreign distributors.[21]

After approximately nine months of operations by overseas nonappropriated fund activities under the provisions of the Presidential Directive of November 17, 1960, as implemented by the Department of Defense, the Secretary of Defense announced a major change in policy governing the sale of foreign goods by nonappropriated fund activities. By Memorandum of August 8, 1961, he stated:

> It is recognized that procurement of locally available foreign items by U. S. personnel in overseas areas produce a more favorable effect on the balance of payments problem if procured through U. S. operated nonappropriated fund resale activities, rather than if such items are procured directly by such personnel on the local economy.
>
> Prior instructions from this office are further modified to authorize these activities to henceforth deal in foreign items with the following provisions:
>
> 1. Transshipment directly between major overseas commands, i.e., USCINCPAC area and USCINEUR area, of items other than beverages, is prohibited.
> 2. Shipments among countries within an overseas command shall be held to a minimum so that, in general, only foreign items readily available locally will be dealt in by nonappropriated fund activities.
> 3. Foreign items, with the exception of beverages, sold through these activities shall be priced at least

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[21] *Idem.*, June 6, 1961.

> as high as in local markets.
>
> Previous instructions in conflict with policy are hereby amended.[22]

As a result of this change in policy, the nonappropriated fund activities reverted back to operations generally the same as were in effect prior to the Presidential Directive of November 17, 1960. This cycle of actions substantiates the theories of many that as long as it is to the financial advantage of the Department of Defense personnel to buy foreign made products, in lieu of United States manufactured products, such purchases will be accomplished.

Reduction of United States Forces Overseas

When the Department of Defense was taking action to implement the President's Directive of November 19, 1960, it was estimated that each dependent overseas spent an average of $1,000 per year in the local economies. In the latter part of 1961, it was estimated that the personal expenditures in the local economies of United States military and civilian forces and their dependents was an average of $750 per year per person, including dependents.[23]

With over one million military and civilian personnel and dependents overseas, it can readily be seen

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[22] Idem., 8 August 1961.

[23] Walter S. Salant, (and others), "U. S. Balance of Payments in 1968," Brookings Institute, p. 145, pp. 298.

as high as in local markets.
Consumer restrictions in connection with pricing are hereby canceled.[illegible]

As a result of this change in policy, the [illegible] [illegible] food activities reverted back to [illegible] [illegible] the same as were in effect prior to the Presidential Directive of November 17, 1960. Many types of [illegible] [illegible] the [illegible] of [illegible] that [illegible] of it by the financial [illegible] of the Department of Defense [illegible] to buy foreign made products in lieu of United States manufactured products, such purchases will be accomplished.

Reduction of [illegible] [illegible]
[illegible] [illegible]

When the Department of Defense was taking action to implement the President's Directive of November 17, 1960, it was estimated that each dependent overseas spent an average of $1,000 per year in the local economies. In the latter part of 1961, it was estimated that the personal expenditures in the local economies by United States military and civilian personnel and their dependents was an average of $500 per year per person (including dependents).[illegible]

With over one million military and civilian personnel and dependents overseas, if they [illegible] [illegible]

[illegible] Ibid., 31 August 1961.

[illegible] [illegible] [illegible] [illegible] [illegible], [illegible] [illegible] [illegible] [illegible] [illegible] [illegible], pp. [illegible] that one major factor contributing to the deficit in the military sector of the United States balance-of-payments was the expenditures on the local economies by these individuals. However, the Kennedy Administration rejected the "easy course of action" for reducing the number of individuals overseas who were associated with our defense posture by rescinding the order of the preceding Administration on the restriction of dependents overseas. In lieu thereof, the Department of Defense undertook a comprehensive review of all United States military units overseas to determine if, in light of the overall defense posture, a reduction of military personnel as well as dependents could be accomplished.

Quick Reaction Airlift Capability

One means for reducing overseas military personnel was to expand the program for prepositioning equipment and supplies in forward areas where trouble is likely to occur and utilize airlift to rapidly transport military forces, held in reserve in some central location within the United States, to the troubled area.

The "Big Lift" exercise conducted in October 1963, when 15,000 military personnel were airlifted from Texas to Western Europe, has been identified as the initial step towards the withdrawal of substantial numbers of United States military personnel from Europe. Although the exercise was not officially announced as a means for reducing the military deficit in the United States balance-of-payments, the exercise was so identified primarily on the basis of the statement made in Chicago, Illinois on that the major factor contributing to the deficit in the military sector of the United States balance-of-payments was the expenditures in the local economies by these individuals. However, the Kennedy Administration rejected the "easy course of action" for reducing the number of individuals overseas [illegible] posture by maintaining the morale of the personnel [illegible] as on the restriction of dependents overseas. In 1963 however, the Department of Defense undertook a compre-hensive review of all [illegible] United States military [illegible] to determine if, in light of the overall military posture, a reduction of military personnel or [illegible] dependents could be accomplished.

MASS TRANSPORT AIRLIFT CAPABILITY

One means for reducing overseas military personnel was to expand the capacity for [illegible] military deployment and transport of [illegible] [illegible] [illegible] forces, [illegible] the United States, to the critical area.

The "Big Lift" exercise conducted in October, 1963, [illegible] to Western Germany, [illegible] [illegible] the United States [illegible] [illegible] on

October 19, 1963, by the Deputy Secretary of Defense, Roswell Gilpatric:

> This Big Lift exercise will demonstrate our ability to project our military power far more quickly over far larger distances than has ever been the case in the past. By employing such a multibase capability, the U. S. should be able to make useful reductions in its heavy overseas military expenditures without diminishing its effective military strength or its capacity to apply that strength swiftly in support of its world-wide policy commitments.[24]

In the eyes of many, the "Big Lift" exercise was termed an overwhelming success in demonstrating how far the United States had come in developing global mobility for its forces. Whereas, others proclaimed it as successful in peacetime, politically dangerous in time of crisis and totally useless in time of an armed conflict:

> There remains a discussion of the airlift in case of the outbreak of an armed conflict . . . picture the situation in Europe after the first day of local nuclear conflict. . . . Let us assume the enemy has attacked. All available tactical aircraft are engaged in counter strikes against the enemy's lines of communication, and their numbers are decimated in the process . . . soon no airfields will remain intact, having been plastered by the enemy's short and medium range missiles. Furthermore, the distance from the border to the supply depots is short, 200 miles or less, so that relatively unsophisticated missiles suffice to destroy them. . . . The Big Lift would find no fighter cover, no airfields, no depots. To send an airlift of the dimensions of Big Lift into the battle zone or the supply depots would be pure folly.[25]

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[24] Roswell Gilpatric, Deputy Secretary of Defense, Speech on October 19, 1963, in Chicago, Illinois, Air Force and Space Digest, December 1963.

[25] Stefan Geisenheyner, "And How Did the Europeans Size Up Big Lift," Air Force and Space Digest, December, 1963, pp. 38-40.

The predictions that United States troops in Europe would be reduced was, from a military view, alarming to some United States Allies. They claimed that any withdrawal of forces from any likely danger zone would increase the risk involved and the temptation for the aggressor to attack. It was stated that United States forces in Europe were by far the strongest deterrent on the ground to an assault by Russia and that a withdrawal of all or part of the United States divisions could tempt her into military ventures that would not be considered if United States forces were present.

On the other hand there are those that felt Europeans should quit applying the "double standard" when discussing the common defense--that of expecting the United States to meet its NATO commitments as a matter of course, while never coming near to fulfilling their own obligations in the alliance. In this connection, General Eisenhower said:

> When I went back to Europe in 1951 to command the forces of NATO, the United States agreed to supply the equivalent of six infantry divisions which were to be regarded as an emergency reinforcement of Europe while our hard-hit Allies were rebuilding their economies and capabilities for supporting defense. Now twelve years later, those forces, somewhat reinforced, are still there. . . . I believe the time has now come when we should start withdrawing some of these troops. Although we have invested billions of dollars in air and naval bases and have built up a supply system all over Europe . . . all this does not seem to have the same effect of "showing the flag" as far as Europeans are concerned, as the presence of U. S. ground troops. . . . One American division in Europe can "show the Flag" as

definitely as can several.[26]

The outright withdrawal of one or more of the United States Army divisions from Western Europe did not result in a substantial reduction in the net deficit in the United States balance of payments. The divisions were located almost entirely within the Federal Republic of Germany, the one NATO country most concerned in a unified common defense afforded by a strong NATO. To help reduce the deficit in the United States balance of payments attributed to military expenditures in Germany, an "offset" agreement was executed by the Federal Republic of Germany with the United States. Under this agreement, the United States provided a cooperative logistic system for the Armed Forces of both countries and the Federal Republic of Germany increased the level of military procurements in the United States and utilized United States supply lines, depots and maintenance and support facilities in amounts which "offset" the foreign exchange costs of maintaining United States forces in Germany. Therefore, a reduction of military expenditures in Germany resulting from the reduction of the number of divisions located in Germany would also result in a corresponding reduction in the amount of the "offset" agreement.

The policy of prepositioning of equipment and supplies and the use of airlift to transport troops to critical areas are considered by the Department of Defense

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[26] Dwight D. Eisenhower, "Lets be Honest With Ourselves II," Saturday Evening Post, October 26, 1963, p. 27.

as tools for use primarily in meeting emergencies created by limited war situations.[27] This factor, coupled with the favorable "offset" agreement with the Federal Republic of Germany, did not support the opinion that "Big Lift" was intended to precede the withdrawal of one or more of the Army divisions from Germany. This question was resolved when the Secretary of State, in a speech at Frankfurt, Germany on October 26, 1963 declared: "We have six divisions in Germany. We intend to maintain these divisions here as long as there is need for them--and under present circumstances there is no doubt that they will continue to be needed. . . ."[28] Further, at a press conference in Washington, D. C. on October 31, 1963, President Kennedy reaffirmed that the United States had no intention of reducing Army strength in Europe under present conditions.[29]

On January 14, 1964, the Department of Defense announced plans to "again demonstrate its ability to deploy combat troops quickly" with the movement of an Army brigade by air from Hawaii to Okinawa. This Pacific exercise will involve the matching of troops with heavy

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[27] U. S. Congress, "A Compilation of Material Relating to United States Defense Policies in 1962," House Document No. 155, 88th Congress, 1st Session, U. S. Government Printing Office, Washington, D. C., 1963.

[28] Dean Rusk, Secretary of State, Press Conference in Frankfurt, Germany on October 26, 1963, Washington Post, October 27, 1963.

[29] U. S. President, 1961-1963 (Kennedy), Press Conference in Washington, D. C. on October 31, 1963, Washington Post, November 1, 1963.

equipment and supplies prepositioned aboard converted Victory ships now moored in Subic Bay in the Philippine Islands.[30]

Rotation of United States Military Personnel

The effective demonstration of military airlift capabilities by "Big Lift" pointed the way towards another possibility for reducing expenditures overseas in both the "individual expenditure" and military expenditure sectors of the United States balance of payments. This plan involved the rotation of entire military units between the United States and overseas locations. Under this concept, the personnel of fully operational and combat-ready forces, deployed in any part of the world, would be rotated with personnel of similar forces located within the United States. By reducing the tours of servicemen involved in such swaps to periods of three, six or twelve month periods the rotations would be accomplished without dependents. Reducing dependents overseas would make possible substantial reductions in support personnel and facilities as well as reducing the percentage of the servicemen's pay and allowances presently available for spending on the local overseas economies. Support of this plan was received from many quarters. Former President Eisenhower stated:

> It would be helpful, at this time, to put all of our troops abroad on a "hardship basis"--that is, send them on shortened tours of foreign duty and without their families as we do in Korea. Unless we

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[30] _Baltimore Sun_, January 14, 1964.

> take definite action, the maintenance of permanent troop establishments abroad will continue to overburden our balance of payments problem. . . .[31]

Others pointed out that the United States Marine Corps had been rotating units between the United States and overseas areas for several years and that, if it works for one of the Services, it would work for the others also. Still others stated that the rotation plan would overcome three of the major criticisms directed at "Big Lift":

1) By maintaining combat-ready troops and equipment in position at all times, the defensive capabilities in the immediate danger zone would not be weakened.

2) Even if, during a rotation airlift, the aggressor struck and destroyed the air bases in the forward area, the incoming personnel could be landed in rear areas and transported by other means to areas of prepositioned equipment and supplies and then used as reinforcements.

3) The equipment and supplies, depended upon to repel the initial strikes of the aggressor, would always be in the hands of troops who would keep it positioned and in constant readiness for such attacks.

On the other hand there are those that contended that the rotation plan was nothing more than a new means for restoring the restrictions of the Presidential Directive of November 17, 1960. They felt that the good and valid reasons, which were the basis for rescinding

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[31] Dwight D. Eisenhower, "Lets be Honest With Ourselves II," Saturday Evening Post, October 26, 1963, p. 27.

the Presidential Directive, were still valid and present. In addition to the hardships created by "separations" from families, they contended that the rotation plan would impose additional financial burdens upon the military families or substantially increase the budgetary cost of the Department of Defense. Questions asked or problems posed most frequently in connection with the rotation plan were: (1) Where will the dependents stay while the fathers and husbands are overseas? (2) Will they be required to vacate the government quarters at the United States installation while the military member is overseas? (3) If they are not required to vacate government quarters, where will the military personnel returning from overseas house their dependents? Most installations within the United States do not have sufficient government quarters to house the military families of the normal assignments to the installation. To double the number of families at an installation would only result in greatly inflated rental and leasing costs of housing in the local community which, in turn, would place an impossible burden upon all military members seeking shelter off the military installation. To resolve the housing problem it would be necessary to construct additional housing at the installation which would be operating under the rotational plans; or, additional military installations would have to be activated (or existing installations, which otherwise would be surplus to the military needs, would have to be retained) solely to accommodate the rotation plan.

The United States Marine Corps rotation program involves the placement of military personnel on temporary duty status while overseas thereby maintaining the

permanent residence of the military dependents at the United States installation. Also, only a portion of the operational forces generally located at a United States Marine Corps installation are involved in the rotation at any one time. It is questionable if similar rotation plans involving entire United States Army divisions or Navy personnel would be feasible or possible.

CHAPTER V

ACCOUNTING OF DEPARTMENT OF DEFENSE ACTIONS TO IMPROVE THE UNITED STATES BALANCE OF PAYMENTS

Numerous questions were raised concerning the accounting methods and reporting procedures for Department of Defense transactions entering the United States balance of payments. It has been alleged that reporting and accounting of cash transactions abroad, did not reflect the net adverse dollar outflow generated by Department of Defense activities in carrying out its overseas commitments. Typical examples cited of erroneous reporting and accounting fall into the following categories:

1) Department of Defense Contracts with Foreign Contractors: The Department of Defense activities execute many thousands of contracts with foreign contractors every year. These contracts are for requirements which have been determined, under provisions of the Department of Defense balance of payments directives, to be of a type or category requiring performance of work under the contract to be accomplished in the overseas area. Although the basic contract is always with a foreign contractor, in the performance of the work it is often necessary for this foreign contractor to subcontract a large portion of the total contract cost for supplies, material and services of United States origin. Yet, in compiling the balance

of payments statistics, the total contract amount of the basic contract with the foreign contractor is recorded and reported as a "United States Government Payment" abroad. Whereas, the shipment of United States origin supplies, equipment and services required for performance under the basic contract are recorded and reported as "Export of goods and Services" usually with little or no identification that these exports were generated by a Department of Defense contract with a foreign contractor.

2) Department of Defense Procurements accomplished through Barter Transactions: One of the provisions of the Agriculture Trade Development and Assistance Act, Public Law 480, 83rd Congress, provides for the disposal of surplus United States Agriculture commodities by barter. Up to 1961, agricultural commodities disposed of through barter were exchanged primarily for foreign-produced strategic and critical materials, the bulk of which was transferred to supplemental and national stockpiles and counted towards achievement of the National Stockpile Objectives. With the sharp curtailment of stockpile of strategic and critical material in 1960 and 1961, efforts were made to expand the use of barter to satisfy other United States government requirements. At the direction of the President of the United States, an Executive Stockpile Committee was established to study the problems of the barter program. Several of the recommendations made in the "Report on the Barter Program" submitted to the President by the Stockpile Committee and approved on September 20, 1962 by the President, were of special concern and interest of the Department of Defense. These recommendations provided that:

> Greater emphasis than in the past should be given to the use of barter transactions for the procurement of non-strategic material items (including but not limited to offshore procurement). . . . The Department of Defense . . . should cooperate with the Department of Agriculture by effecting offshore procurement, using qualified barter arrangements to the greatest practicable extent when dollars would otherwise be spent abroad for the items being procured. . . . Offshore military procurement by barter should not be effected in West Germany or any other country in which the United States has arrangements for payments to offset United States military expenditures in that country, except with the concurrance of the Secretary of the Treasury. . . . In addition to the foregoing, the Department of Defense . . . should continue to cooperate with the Department of Agriculture to convert to barter arrangements dollar contracts for foreign-produced items.

Department of Defense barter procedures and instructions were issued in February 1963. From March thru December 1963, Department of Defense activities overseas accomplished barter procurements which totalled approximately fifty million dollars. Even though the barter transaction does not result in any dollar outflow from the United States (only surplus agriculture commodities are shipped from the United States, with the Department of Defense contractor paid from the proceeds of the sale of these commodities in foreign countries) the Department of Defense contract is recorded as a "United States Government Payment" abroad. In turn, the shipments of agriculture commodities under the barter transaction are reflected in the balance of payments as "Exports of goods and Services" usually with little or no reference that such exports were generated by a Department of Defense procurement abroad.

Although the reporting and recording of transactions, as outlined above, balance out in the overall

United States balance of payments statistics, to the uninformed it appears that the Department of Defense is the major and primary contributor in the growing amount of outstanding dollars and dollar claims held by foreign financial institutions and foreign individuals.

In order to clearly define and identify the net adverse effect of Department of Defense expenditures in support of overseas military operations, the Department of Defense, issued Directive No. 7360.7, dated July 1, 1963, which identified, among other things, those transactions which did not result in an adverse dollar outflow to foreign governments, individuals and institutions.

CHAPTER VI

CONCLUSIONS AND OBSERVATIONS

The Department of Defense initiated and implemented vigorous and aggressive actions to reduce the net adverse effect military expenditures abroad had upon the United States balance of payments during the period covered by this paper.

The program to restrict procurement of foreign manufactured or produced products resulted in sizable reductions in the "military expenditure abroad" sector of the United States balance of payments. However, such reductions were accomplished at an increased cost to the Department of Defense budget of approximately 28 per cent above the costs which would have been incurred if foreign products had been purchased. Additional reductions of approximately seventy million dollars could have been realized in this area by increasing the price differential allowed in the procurement of commodities or services of United States origin; however, such additional reductions would increase Department of Defense costs by at least 50 per cent for each additional dollar's worth of requirements returned to the United States for purchase.

Additional savings in expenditures for new facilities and/or repair of existing facilities could be accomplished only by a substantial reduction in the number of military units, personnel, and dependents assigned to overseas areas.

The negotiations and expansion of "Offset Agreements" with foreign governments for joint use of facilities and for the purchase of United States manufactured military products, to compensate for the costs of maintaining United States military units in overseas areas, represented during the time frame under examination, the most significant method for effecting further reductions in the balance of payments deficits attributed to United States overseas military commitments.

Voluntary programs for the reduction of personal expenditures in foreign countries by Department of Defense personnel and their dependents were of questionable value.

Mass rotation of combat units between the United States and overseas locations would require a sizable increase in the overall Department of Defense appropriations. The rotation of small units, without dependents would have contributed considerably in the reduction of personal expenditures.

Past identification and reporting procedures of transactions entering the United States balance of payments reflected a distorted picture of the net adverse effect military expenditures abroad were having on the overall balance of payments.

However, after some reflection, it is the considered opinion of this author that further research and study of this very complex problem be conducted. A possible point of interest for some future scholar would be a consideration of the advisability and ramifications involved in checking the U. S. balance of payments deficits through direct foreign support of U. S. Forces. This would, of course, involve quantifying the costs and benefits

The negotiations and agreements of offset arrangements with foreign governments for joint use of facilities and for the purchase of United States manufactured military products, to compensate for the costs of maintaining United States military units in overseas areas, represented during the time frame under examination, the most significant method for offsetting foreign exchange in the balance of payments deficits attributed to United States overseas military commitments.

Voluntary programs for the reduction of personal expenditures in foreign countries by Department of Defense personnel and their dependents were of questionable value.

Unit rotation of combat units between the United States and overseas locations would require a greater increase in the overall Department of Defense appropriations. The rotation of small units, without dependents would have contributed considerably to the reduction of personal expenditures.

Past identification and reporting procedures of transactions affecting the United States balance of payments portrayed a distorted picture of the net effect direct military expenditures should have had on the overall balance of payments.

However, after some reflection, it is the considered opinion of this author that further research and study on this very complex problem be conducted. A possible point of interest for some future analysis would be a consideration of the advisability and ramifications involved in offsetting the U. S. balance of payments deficits through direct foreign support of U. S. forces. This would, of course, involve quantifying the costs and benefits associated with the "U. S. Defense Umbrella" that protects much of the free world. Is it too much to ask for an equitable contribution from ones Allies toward the maintenance of his security? Furthermore, is the U. S. balance of payments position best served by requiring a "buy American policy" in the distribution of largesse through offset agreements? Is it possible that U. S. policy, and therefore its balance of payments position, might be best served by removing all restrictions concerning the market place in which U. S. foreign aid is spent, but at the same time, insist that recipient countries contribute to their national security on an equitable basis consistent with the ability of each to contribute? The significance of the answers to the questions posed are obvious and adoption of them could generate sufficient cash flows into the U. S. Treasury to return and maintain a favorable balance in gold payments. The advisability of pursuing this course of action and an in depth analysis of the ramifications involved are subjects certainly worthy of further investigation.

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